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From:

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To:

Cc:

Subject: RE: IRC sec 6521 situation

Thanks for your patience with this -- the short answer is that only the employee portion of the employment taxes can be used to offset the self-employment tax refunds. Detailed answer follows:

You asked us about refunds being made to taxpayers whose employment status is being re-determined. These taxpayers originally classified themselves as self-employed, and reported and paid self-employment taxes on their Form 1040 returns. Their employers did not withhold or pay employment taxes for them.

Now that they are being re-classified as employees, many of these taxpayers have filed refund claims to recover the self-employment taxes they erroneously paid. The refund statute of limitations was open at the time the claims were made. However, the assessment period of limitations has expired for the employment taxes that these taxpayers and their employers should have paid.

The Service would like to know if it can offset the refunds of self-employment tax with the un-assessed employment taxes, and if so, can they apply both the employee and the employer shares when they do the offset.

We conclude that the Service may offset the self-employment tax refunds through the application of I.R.C. § 6521, but only with the employee portion of the employment taxes.

Section 6521 provides:

In the case of the tax imposed by chapter 2 (relating to tax on self-employment income) and the tax imposed by section 3101 (relating to tax on employees under the Federal Insurance Contributions Act)—

(1) If an amount is erroneously treated as self-employment income, or if an amount is erroneously treated as wages, and

(2) If the correction of the error would require an assessment of one such tax and the refund or credit of the other tax, and

(3) If at any time the correction of the error is authorized as to one such tax but is prevented as to the other tax by any law or rule of law (other than section 7122, relating to compromises),

then, if the correction authorized is made, the amount of the assessment, or the amount of the credit or refund, as the case may be, authorized as to the one tax shall be reduced by the amount of the credit or refund, or the amount of the assessment, as the case may be, which would be required with respect to such other tax for the correction of the error if such credit or refund, or such assessment, of such other tax were not prevented by any law or rule of law (other than section 7122, relating to compromises).

The situations you describe appear to meet the requirements of section 6521. First, income was erroneously treated as self-employment. Second, correction of the error would require an assessment of employment taxes and a refund or credit of the self-employment taxes. Finally, assessment of the employment taxes is prevented by the I.R.C. § 6501 period of limitations on assessment. Thus, you may offset the refunds of self-employment tax due the employees under 6521.

However, this offset is limited by the language of the statute to “tax imposed by section 3101,” which is the employee portion of the employment taxes. The employer portion is governed by I.R.C. § 3111. Treas. Reg. § 31.3102-1(d) provides that an employee is responsible for the employee’s share of employment tax until it is collected from him or her by the employer. Therefore, in cases like yours, where no employment tax was collected, the employees remain liable for the § 3101 employee share of tax.

The various provisions of the IRM which address section 6521 correctly reflect that offset should be limited to the employee share. For example, see IRM 4.23.8.5.3(3), which gives an example of how a self-employment tax refund should be offset by the amount of the employee’s share of the tax imposed on that employee under § 3101.

Finally, this approach has also been endorsed by the Tax Court in Beane v. Commissioner, T.C. Memo. 2009-152 (allowing Service to offset a refund of self-employment tax with the employee’s portion of unassessed employment taxes).

Please note that if in any given case the assessment statute for the employee portion of the employment tax has not expired at the time the self-employment tax refunds are authorized, section 6521 does not apply. In that case, an assessment should be made against the employee-taxpayer for the employee portion of the tax.

If you have any questions, please let me know.